westerra CREDIT UNION

March 9, 2010

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Dear Ms. Rupp:

On behalf of Westerra Credit Union, we appreciate the opportunity to comment on the National Credit Union Administration's (NCUA) proposed amendments to Part 704. Westerra Credit Union holds $1.17+ billion in assets and serves over 87,000 members in Colorado. We agree that change in the corporate credit union system is necessary and share NCUA's desire to improve and strengthen the corporate system. We understand the proposed amendments to Part 704 make major revisions regarding corporate credit union capital, investments, asset-liability management, governance and credit union service organization (CUSO) activities.

While the proposed NCUA Regulation Part 704 makes some beneficial changes that will reduce risk and augment the value of corporate credit unions going forward the proposed rule raises many concerns. If enacted as proposed, there are several provisions that will make it essentially impossible for corporate credit unions to operate in any viable fashion which will ultimately be harmful to natural person credit unions (NPCUs), and ultimately, our members. Our primary concerns are as follows:

Growth of retained earnings needed to meet capital levels

The preamble to the NCUA proposed rule contains an example of the ability of a corporate credit union to grow earnings under the proposed investment and ALM limitations. The example is based on several key assumptions regarding the business model that we believe are unrealistic. Those key assumptions in question are:

- No cost of capital is included – Members will not likely contribute additional capital under this scenario.
- Extremely high yielding, single asset class concentration (private student loan ABS) – The proposed levels of investment in this asset class do not seem prudent.
- Private student loan sector is not deep enough to support aggregate corporate demand and this segment of investments was projected to produce almost 60% of projected corporate income.
- Ignores impact of legacy assets – Corporates that have OTTI on their books still have adjustments to net interest income going forward that will impact them being able to meet new capital requirements. In addition, members are unlikely to re-capitalize the corporates if their newly contributed capital will be exposed to losses from legacy assets.

- Other provisions of the proposed regulation discussed below also limit the ability of the corporate credit union to generate earnings at a level to grow retained earnings at the pace needed to reach capital requirements in the required timelines, especially give the current economic environment.

Treatment of Legacy Assets
This significant issue is not currently addressed in the proposed regulation. In a recent town hall meeting, NCUA indicated natural person credit union participation is "crucial to an ongoing (corporate) system." This participation is the recapitalization of the corporate system. Natural person credit unions are going to want to know new capital invested to benefit the future operations of the corporate will not be used/depleted to cover losses related to legacy assets. If this is not the case, it would be difficult for NPCUs to say it is in the best interests of their members to invest additional money in the capital of the corporate credit union system. NCUA has been working in conjunction with the US Treasury Department on this issue, but until this work is completed and we have guidance on how newly invested capital will be affected by the legacy assets, changes to the regulations for the corporate credit union system should be postponed.

704.2 Definition of "available to cover losses"
The NCUA continues to require that NPCU capital be extinguished based on estimates of future losses and prohibits the return of capital if the estimate of losses do not materialize. Even though accounting practice requires the recognition of these estimates as current period losses (the credit portion), the regulations do not currently require the extinguishment of capital. The NCUA consistently references 704.2, the definition of capital, as the basis for taking capital. We strongly believe this is inappropriate and is inadequate support for such a proposition. The NCUA is not required to take the capital as an offset and, as has previously been proven, can permit corporates to operate with negative retained earnings.

The proposed regulation includes specific wording that requires corporates to take capital as the NCUA is currently directing. We are not aware of any other financial institution regulator that is making this same requirement. Other regulators, including those who have oversight of the Federal Home Loan Banks, have permitted their constituents to use a regulatory capital instead of a GAAP capital requirement. In fact, the NCUA is permitting corporates to use regulatory capital standards as of November 30, 2008 to determine capital. We request the extinguishment requirements be removed from the proposed regulation and that NCUA immediately begin using existing authority to permit regulatory capital to be used to allow corporates not to extinguish NPCU capital until actual cash flow losses occur and exceed retained earnings. In addition, once a corporate meets all applicable regulatory mandates, a provision should be outlined to allow the return of extinguished capital to the original capital holders, or a "recovery dividend", if estimated losses do not materialize based on measuring the performance of previously impaired legacy assets from all other assets.

704.6 (c) & (d) Concentration limits
As written, Federal Funds transactions are not specifically excluded from the sector concentration limits. As a result, corporate would be severely challenged to invest short-term liquidity at reasonable rates. This will have the harmful effect of reducing the overnight rates

that member credit unions receive from their corporate. We recommend that the definition of deposits in 704.6 (d) be amended to include Federal Funds, or include Federal Funds transactions in the exemption from sector concentration limits. Also, amend 704.6 (c) to allow a larger single obligor limit of 200% of capital on money market transactions with a term of 90-days or less. An alternative solution might be to specifically allow a single obligor limit of 200% of capital for Federal Funds transactions sold to other depository institutions.

704.8 (c) Penalty for early withdrawals on corporate certificates

This proposed provision limits a corporate credit union's ability to pay a market based premium on an early withdrawal of a certificate of deposit. This effectively takes away the corporate credit union's ability to redeem the certificate at the prevailing market price, thus handicapping the liquidity feature of such investments. This will therefore place corporate credit unions at a distinct disadvantage to Agency issued debt. In order to compete against other more liquid investments, corporates would need to compensate for this by adjusting yields higher, or their members will potentially move investments. It is very unlikely, given other parts of the proposed regulation, that the corporate credit unions would have the ability to afford this so this would likely lead to a significant reduction in overall liquidity in the corporate credit union system as natural person credit unions would be compelled to put investable funds where they will not be penalized for early redemption due to liquidity needs. This reduction in term funding at the corporate credit unions will cause them to maintain higher levels of short-term assets for liquidity and volatility limit conformity which reduces the corporate credit union's ability to generate net interest income to build retained earnings and would negatively impact the corporates' ability to fund natural person credit union lines of credit. We therefore recommend this be removed from the proposed regulation as it is not only counterproductive to maintaining corporate liquidity and natural person credit union investment options, it will also likely have long-lasting and harmful effects to the system.

704.8 (e) & (f) Average-life NEV testing

We are troubled that analyses indicate that there is no combination of assets – with a two-year average life and limited extension risk – that could generate sufficient margin *and* pass a 300 basis point credit shock test. Further, the proposed limitations placed upon a corporate by these tests would not allow corporates to generate sufficient interest margin to build retained earnings to meet the new capital requirements contained in the proposal. Any ability to generate a reasonable interest margin in order to build retained earnings will come from taking on additional credit risk in the portfolio or becoming very dependent upon a lower cost of funds, which means a lower yield paid to members resulting in the same liquidity pressures on corporate credit unions discussed above. The provisions of this section must be modified to balance the need to manage risk with the need to generate sufficient income to build critically-needed capital. The NCUA board should review and assess comments and analysis received from commenters regarding the viability and reasonableness of the tests and the two year average weighted life limitation, as well as historical trends to ensure a reasonable balance is reached that will support the ongoing viability of the corporate credit union system.

704.8 (h) Weighted average asset life

This provision limits the weighted average life (WAL) of a corporate credit union's aggregate assets to two years, and includes loans to members. Such a requirement will have numerous adverse implications for natural person credit unions including the following:

- Less Liquidity – NPCU ability to borrow funds beyond two years will be adversely affected. Most loans will need to be made at a shorter maturity. The corporate will need to maintain the WAL of its loan portfolio within the two year limit.
- Higher Loan Rates – If a longer term loan is granted, a significantly higher rate and fees will be charged to compensate for the negative impact on the WAL test. As a result, long-term financing to NPCUs will be drastically reduced and NPCU's will have to seek out less beneficial, or more expensive funding from other sources.
- Higher Fees for Products and Services – To meet NPCU loan demand, the corporate will have to keep securities well under the two year limit. Reduced investment income for the corporate will result in higher fees to their members for all other services.
- Lower Rates on Corporate Certificates – The two year WAL will drastically affect the corporate investment portfolio by reducing yield, investing in investments that provide cash flow, and impacting diversification of the securities in the portfolio resulting in a reduction in rates making investment offerings to NPCU's uncompetitive.

We encourage the Board to exclude loans from the calculation of weighted average life of the investment portfolio. After all, corporate credit unions were founded to provide liquidity to NPCUs – not only their short term needs but also medium and long term needs.

704.8 (k) Overall limit on business generated from individual credit unions

This provision prohibits a corporate from accepting from a member credit union or *other entity* any investment in excess of 10 percent of the corporate's daily average net assets, with the objective of reducing risks that could arise from placing undue reliance on a single entity. This makes sense from an individual credit union standpoint. However, many corporates utilize inter-month funding when needed to address short-term liquidity volatility. Typical sources of these funds include the Federal Reserve Bank and the Federal Home Loan Bank. Including "other entities" in the 10 percent limit may force corporates into short-term borrowing with less favorable terms or to maintain larger cash balances both which would likely negatively impact earnings. This may also limit the corporates' ability to provide their member credit unions with reasonably priced short-term liquidity.

We would request that the NCUA consider allowing borrowings with a maturity of 30 days or less from the Federal Reserve Bank, a Federal Home Loan Bank, a Repurchase Agreement counterpart or a Federal Funds counterpart, in excess of 10% of the corporate credit union's moving daily average net assets. Alternatively, this issue could be addressed by eliminating the "or other entity" language in the proposed regulation.

Corporate Governance

For more effective management of risk we would recommend that the Supervisory Committee be eliminated and that the Board of Directors be fully responsible for overseeing/staffing all aspects of the Audit Committee charter.

In closing, we thank the NCUA Board for the opportunity to comment on NCUA's proposed amendments to Part 704 related to the corporate credit unions and hope that the Board amends the proposed rule to address the concerns and recommendations we have outlined in this letter. It is very clear from recent events that something needs to be done for natural person credit unions to regain trust in the corporate credit union system. Natural person credit unions have looked to the corporate credit unions for the services necessary to operate, and corporate credit unions have looked to the natural person credit unions for capital. There is a need to address shortcomings in the system while also ensuring a viable business model for the corporate credit unions so they may continue for the benefit of natural person credit unions and their members.

Sincerely,

C. Alan Peppers

C. Alan Peppers
President/CEO

Betsy H. Guerrero, CPA
Chief Financial Officer